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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 29.

AMERICAN SURETY COMPANY OF NEW YORK, *Petitioner*,

v.

THE BETHLEHEM NATIONAL BANK OF BETHLEHEM, PENNSYLVANIA, and L. M. REED, Receiver, The Bethlehem National Bank of Bethlehem, Pennsylvania, *Respondents*.

BRIEF FOR THE RESPONDENTS.

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(2)—It would seem entirely clear, in principle, that the fact that the principal has become insolvent, and has been placed in liquidation proceedings, does not permit enhancement of, or increase in, the face amount of the provable claim of the surety in the liquidation proceedings. As

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previously indicated, the basis of reimbursement of the surety is measured by the amount he is required to expend for the benefit of the creditor under bond.

Any possible doubt in this connection, so far as concerns provable claims against insolvent national banks in receivership, is removed by the provisions of section 5236, Revised Statutes, (Sec. 194, Title 12, U. S. C.), requiring ratable dividends, and by construction of the statute by the courts, to the effect that the claims established thereunder must be in the amount owing to the claimant by the bank as of the date of closing of the bank 8

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(2)—In balancing the equities, the general depositors and creditors of the receivership bank are entitled to have the benefits of the surety bond, rather than to have it weighed in the balance against them. The District Court, (R. 16-17) and also petitioner, in adopting (page 15 of his petition for writ of certiorari) the position and reasoning of the District Court—to the effect that the general depositors and creditors of the bank would be receiving a "windfall" by reason of "purely for-

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 29.

AMERICAN SURETY COMPANY OF NEW YORK, *Petitioner*,

v.

THE BETHLEHEM NATIONAL BANK OF BETHLEHEM, PENNSYLVANIA, and L. M. REED, Receiver, The Bethlehem National Bank of Bethlehem, Pennsylvania, *Respondents*.

BRIEF FOR THE RESPONDENTS.

I.

THE FACTS.

The facts are not in dispute. The case was decided upon the pleadings, (consisting of the bill of complaint and exhibits thereto attached (R. 2-10), and the motion to dismiss, —R. 10) as supplemented by two stipulations of counsel (R. 11-13; 21-22). The allegations and statements comprised within the pleadings and the stipulations, are summarized in the petition for writ of certiorari (pp. 2-4; 9-10).

However, in view of the fact that the bond securing the deposit of the Commonwealth of Pennsylvania (signed by

the bank as principal, and by petitioner as surety), was dated and became effective as of *December 10, 1928*, whereas the bank was placed in conservatorship on *March 15, 1933*, it was deemed appropriate to remove any doubt that might be entertained,—from the face of the record,—as to whether the bond had been kept continuously in force and effect by the payment by the bank to the surety of the required annual premiums during said period. Hence, by agreement of counsel, a letter was written by counsel for petitioner, dated October 10, 1941, clarifying the record in this respect, with the understanding, as indicated in said letter, that the facts therein stated should be

> "submitted to the Supreme Court of the United States for its consideration to the same extent and effect as if included in the formal transcript of record, and that our agreement in this regard may be evidenced by the insertion of a copy of this letter as an appendix of Respondents' brief which you are about to file."

Accordingly, a true copy of said letter of October 10, 1941, is contained in the appendix hereof at p. 28.

Attention is also directed to an inadvertent but erroneous assumption of fact by the District Court to the effect that the surety bond in question had been "bought and paid for" by the Commonwealth of Pennsylvania (R. 16):

> "On the one hand, if the surety be allowed dividends on the full amount of the creditor's claim, they will be based upon an amount in excess of what he has expended, whereas the general creditors will be sharing only on the basis of their actual advancements. If, on the other hand, the surety is limited to the amount which he has actually paid as the basis of his claim, *then the general creditors get a windfall, for no other reason than that one of them has bought and paid for additional protection which none of the others chose to take*—for, of course, if there had been no suretyship, the creditor would be proving and receiving dividends on the full amount of his claim." (Italics inserted)

II.

QUESTIONS PRESENTED.

The questions presented are summarized in the following extract from the opinion of the court below: (R. 16)

> "The question before the court on this appeal is the basis upon which the plaintiff surety might prove and receive dividends. Plaintiff takes the position that it is entitled to dividends upon the full amount of its obligee's original bank claim which was $135,000. The court below, after a carefully prepared and thoughtfully reasoned opinion, sustained the plaintiff's view. The receiver contends that plaintiff is entitled to participate in the liquidation of the bank to the extent of a claim of $68,588.56, the amount it actually paid to the Commonwealth. There is also the question of whether the plaintiff is entitled to interest upon further dividends which have been declared and paid to other creditors, but which the plaintiff has not received."

III.

SUMMARY OF ARGUMENT.

A.

THE CLAIM OF A SURETY FOR REIMBURSEMENT MUST BE MEASURED BY THE AMOUNT THE SURETY ACTUALLY PAYS THE PRINCIPAL'S CREDITOR UNDER THE REQUIREMENTS OF THE SURETY'S BOND. THE FACT OF INSOLVENCY OF HIS PRINCIPAL DOES NOT PERMIT ENHANCEMENT OF, OR INCREASE IN, THE FACE AMOUNT OF SAID CLAIM AS PERMITTED TO BE FILED IN THE INSOLVENCY PROCEEDINGS AS A BASIS OF DIVIDEND PAYMENTS THEREON TO THE SURETY FROM THE ESTATE OF HIS PRINCIPAL.

(1) It is settled law that the claim of the surety for reimbursement from the principal, or from the estate of the principal, must be measured by the amount paid by the

surety to the creditor of the principal under the requirements of the surety bond. This is the measure of recovery, irrespective of whether reimbursement is sought upon a claim of indemnity, or under a claim of subrogation.

(2) It would seem entirely clear, in principle, that the fact that the principal has become insolvent, and has been placed in liquidation proceedings, does not permit enhancement of, or increase in, the face amount of the provable claim of the surety in the liquidation proceedings. As previously indicated, the basis of reimbursement of the surety is measured by the amount he is required to expend for the benefit of the creditor under bond.

Any possible doubt in this connection, so far as concerns provable claims against insolvent national banks in receivership, is removed by the provisions of section 5236, Revised Statutes, (Sec. 194, Title 12, U. S. C.), requiring ratable dividends, and by construction of the statute by the courts, to the effect that the claims established thereunder must be in the amount owing to the claimant by the bank as of the date of closing of the bank:

B.

IT WOULD BE INEQUITABLE TO THE GENERAL DEPOSITORS AND CREDITORS OF THE RECEIVERSHIP BANK TO ALLOW THE SURETY COMPANY, BY SUBROGATION OR OTHERWISE, A CLAIM, AS THE BASIS OF DIVIDENDS; IN THE SUM OF $135,000, REPRESENTING THE FULL AMOUNT OF THE DEPOSIT OF THE COMMONWEALTH AT THE TIME OF THE SUSPENSION OR CLOSING OF THE BANK.

(1) The deposit balance to the credit of the Commonwealth on the date of suspension or closing of the bank was more than double the amount permitted by the State statute and hence, to the extent at least of the excess, was illegal.

(2) In balancing the equities, the general depositors and creditors of the receivership bank are entitled to have the benefits of the surety bond, rather than to have it weighed in the balance against them. The District Court, (R. 16-17) and also petitioner, in adopting (page 15 of his petition for writ of certiorari) the position and reasoning of the District Court—to the effect that the general depositors and creditors of the bank would be receiving a "windfall" by reason of "purely fortuitous" (R. 17) circumstances, in consequence of the execution of the surety bond—were clearly in error, both in reasoning, and in the assumptions of fact, upon which reliance was made.

C.

THE CASE OF MERRILL v. NATIONAL BANK OF JACKSONVILLE, (1899) 173 U. S. 131, RELIED UPON BY PETITIONER, DOES NOT SUPPORT HIS POSITION, BUT, TO THE EXTENT APPLICABLE TO THE INSTANT CASE, SUPPORTS THE POSITION OF RESPONDENT.

(1) Analysis of the Merrill case:

(2) Comments and observations concerning the Merrill case in so far as it may apply to, or may be distinguished from, the instant case:

IV.

ARGUMENT.

A.

THE CLAIM OF A SURETY FOR REIMBURSEMENT MUST BE MEASURED BY THE AMOUNT THE SURETY ACTUALLY PAYS THE PRINCIPAL'S CREDITOR UNDER THE REQUIREMENTS OF THE SURETY'S BOND. THE FACT OF INSOLVENCY OF HIS PRINCIPAL DOES NOT PERMIT ENHANCEMENT OF, OR INCREASE IN, THE FACE AMOUNT OF SAID CLAIM AS PERMITTED TO BE FILED IN THE INSOLVENCY PROCEEDINGS AS A BASIS OF DIVIDEND PAYMENTS THEREON TO THE SURETY FROM THE ESTATE OF HIS PRINCIPAL.

(1) It is settled law that the claim of the surety for reimbursement from the principal, or from the estate of the principal, must be measured by the amount paid by the surety to the creditor of the principal under the requirements of the surety bond. This is the measure of recovery, irrespective of whether reimbursement is sought upon a claim of indemnity, or under a claim of subrogation.

> "Subrogation gives indemnity only. It cannot take place beyond the amount actually disbursed under legal necessity." (60 C. J. page 724)

To the same effect: (Restatement of the Law—Restitution—sec. 162(c))

> "c. *Where obligation not fully discharged.* Where property of one person is used in partially discharging an obligation owed by another, and the balance of the obligation has not been discharged, the former is not entitled to be subrogated to the position of the obligee. Until the obligation is fully discharged, the obligee is himself entitled to enforce the balance of his claim, and the person whose property has been used in dis-

charging only a part of the claim is not entitled to occupy his position. *If the balance of the claim is subsequently discharged by the obligor, however, the person whose property was used in discharging a part of the obligation is entitled then to be subrogated to the claim to the extent that his property was used in discharging the claim.* (Italics inserted)

"" 'rations:

"1. A owes B $100 and C is surety for A on the debt. C pays B $25 in part payment of the debt. C is not entitled to be subrogated to B's claim against A, although he is entitled to reimbursement from A.

"2. *The facts are as stated in Illustration 1, except that A has paid B the balance of the debt. C is entitled to be subrogated to B's claim against A to the extent of $25.*" (Italics inserted)

Also see: *Memphis & Little Rock Railroad* v. *Dow*, (1887) 120 U. S. 287, 302; *In re Freeman & Brooks* (C. C. A. 7, 1924), 1 F. (2d) 430, 434; *Lacy* v. *Maryland Casualty Co.* (C. C. A. 4, 1929), 32 F. (2d) 48, 53; *Union Indemnity Co.* v. *Stevens* (C. C. A. 5, 1932), 57 F. (2d) 839, 840; *In re Kent Refining Co.* (W. D. Mich., 1937), 20 F. Supp. 661, 662; *In re Metropolitan Motor Car Co.* (Mass. 1924), 299 Fed. 320, 322; *The Livingstone* (C. C. A. 2, 1904) 130 Fed. 746, 749; *Brown* v. *Thompson, et al.*, 128 S. E. 309, 312; 99 W. Va. 56; *Napier* v. *Duff*, (1939) 281 Ky. 779, 136 S. W. (2d) 1083, 1086; *Smith* v. *Wells*, (Ind. 1919) 122 N. E. 334, 338; *Faires* v. *Cockerell*, 31 S. W. 190, 193; 88 Tex. 428; *Phipps* v. *Fuqua* (Tex. Civ. App. 1930), 32 S. W. (2d) 660, 663; *Reserve Loan Life Insurance Co.* v. *Dulin* (Ind. App. Ct. 1919), 122 N. E. 3, 7; *Batsell* v. *Richards* (Tex. 1891), 16 S. W. 313, 314; *Royal Indemnity Co.* v. *White Engineering Corp.*, 120 Misc. 332, 198 N. Y. S. 264, 270; *Krebs* v. *Bezler* (Mo. 1936), 89 S. W. (2d) 935, 937; *Gifford* v. *Rising* (Supreme Ct. N. Y. 1891), 12 N. Y. S. 430; *25 R. C. L.* pg. 1389; *60 C. J.* pg. 724.

As to the functional similarity of operation of the remedies of indemnity and of subrogation:

"A surety who has undertaken to pay the creditors of the principal, though not beyond a stated limit, may

not share in the assets of the principal by reason of such payment until the debts thus partially protected have been satisfied in full. This is the rule where the right to a dividend has its basis in the principle of equitable subrogation. 'A surety liable only for part of the debt does not become subrogated to collateral or to remedies available to the creditor unless he pays the whole debt or it is otherwise satisfied.' *United States* v. *National Surety Co.*, 254 U. S. 73, 76. If the holding were different, the surety would reduce the protection of the bond to the extent of its dividend in the assets of the debtor. *Jenkins* v. *National Surety Co., supra.* The rule is the same, and for like reasons, where the basis of the claim is the debtor's promise to indemnify, if the debtor is insolvent when the promise is enforced. *Jenkins* v. *National Surety Co., supra*, at pp. 266, 267." *American Surety Co.* v. *Westinghouse Electric Manufacturing Co. et al.*, (1935) 296 U. S. 133, 137.

(2) It would seem entirely clear, in principle, that the fact that the principal has become insolvent, and has been placed in liquidation proceedings, does not permit enhancement of, or increase in, the face amount of the provable claim of the surety in the liquidation proceedings. As previously indicated, supra, page 6, the basis of reimbursement of the surety is measured by the amount he is required to expend for the benefit of the creditor under the bond.

Any possible doubt in this connection, so far as concerns provable claims against insolvent national banks in receivership, is removed by the provisions of section 5236, Revised Statutes, (Sec. 194, Title 12, U. S. C.), requiring ratable dividends, and by construction of the statute by the courts, to the effect that the claims established thereunder must be in the amount owing to the claimant by the bank as of the date of closing of the bank:

"§ 194. Dividends on adjusted claims; distribution of assets

"From time to time, after full provision has been first made for refunding to the United States any de-

> ficiency in redeeming the notes of such association, the comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, shall be paid over to the shareholders of such association, or their legal representatives, in proportion to the stock by them respectively held. (R. S. § 5236.)"

To the effect that the amount of the provable claim for dividend purposes must be the amount owing to the claimant by the bank as of the date of closing of the bank, see: *Merrill* v. *National Bank of Jacksonville*, (1899) 173 U. S. 131, 146; *White* v. *Knox*, (1884) 111 U. S. 784, 786; *Scott* v. *Armstrong* (1892) 146 U. S. 499, 511; *City of Fort Worth* v. *McCamey* (C. C. A. 5, 1937), 93 F. (2d) 964, 969; *cert. denied* 304 U. S. 571; *Steele* v. *Randall* (C. C. A. 8, 1927), 19 F. (2d) 40, 42; *McDonald* v. *Chemical National Bank* (1899), 174 U. S. 610, 619; *McCandless* v. *Dyar* (S. D. 1928), 34 F. (2d) 989, 991; *Ross* v. *Lee* (S. D. Fla. 1936), 15 F. Supp. 972, 973.

B.

IT WOULD BE INEQUITABLE TO THE GENERAL DEPOSITORS AND CREDITORS OF THE RECEIVERSHIP BANK TO ALLOW THE SURETY COMPANY, BY SUBROGATION OR OTHERWISE, A CLAIM, AS THE BASIS OF DIVIDENDS, IN THE SUM OF $135,000, REPRESENTING THE FULL AMOUNT OF THE DEPOSIT OF THE COMMONWEALTH AT THE TIME OF THE SUSPENSION OR CLOSING OF THE BANK.

It is settled doctrine that subrogation is entirely an equitable right, and it is not inevitably and inflexibly applied or allowed in all cases. A general statement of the law in

this respect is contained in *Sheldon on Subrogation*, (2d Ed.) sec. 4, p. 5:

> "*It is a Mode of Equitable Relief.*—Subrogation is an exercise of the equitable powers of the court, to relieve a meritorious creditor, who might otherwise be subjected to loss by his funds being applied to pay another's debt, or by the operation of proceedings at law against the estate or funds of one who is indebted both to him and to others. This remedy is allowed only when it does not conflict with the legal or equitable rights of other creditors of the common debtor; and the principle is one of equity merely, and will be carried out in the exercise of a proper equitable discretion, with a due regard to the legal and equitable rights of others. One who claims this equity must be governed by the common maxim, *Sic utere tuo ut alienum non laedas.*"

Also see *Aetna Life Insurance Co.* v. *Middleport*, (1888) 124 U. S. 534, 549, 550.

For the reasons hereinafter indicated, it is considered, that under the facts and circumstances existing in the instant case, the surety should not be allowed a claim against the receivership, for dividend purposes, in excess of the sum of $68,588.56, representing the amount paid by the surety to the Commonwealth, under the terms of the bond. (R. 4, 6)

It may well be, in view of the restrictions contained in the State statutes relating to State deposits, hereinafter next discussed, that the surety should not be allowed a claim in excess of $62,500, inasmuch as that sum is the maximum amount that could be legally deposited under a bond of $125,000.00

(1) The deposit balance to the credit of the Commonwealth on the date of suspension or closing of the bank was more than double the amount permitted by the State statute and hence, to the extent at least of the excess, was illegal.

The Pennsylvania statutes, hereinafter next quoted, prohibit the deposit of state funds in a sum greater than

one-half of the amount of the bond required to be furnished by the depository. The amount of petitioner's bond in the instant case was $125,000.00 (R. 3). The amount of the deposit to the credit of the Commonwealth at suspension of the bank was $135,000.00 (R. 3). Therefore the maximum amount legally permitted to be on deposit under the security of the $125,000.00 bond, was $62,500.00, thereby resulting in an illegal excess of $72,500.00. The controlling state statutes in this connection provide:

Sec. 3812, Title 72, Purdon's (1936) Pa. Stats.

> "The state treasurer before making such deposits shall require each bank, banking institution or trust company to give a good and sufficient bond, containing a warrant of attorney to confess judgment in favor of the commonwealth in double the amount of the contemplated deposit, with sureties to be approved by the board of revenue commissioners of the commonwealth of Pennsylvania, and no deposit shall at any time be greater than one-half of the amount of the bond furnished by said depository. And, further, the said bond or bonds so given shall include a special obligation to settle with and pay to the state treasurer, for the use of the commonwealth, the amount of interest as it shall become due, semi-annually (1897, June 15, P. L. 157, Sec. 2.)"

Sec. 3791, Title 72, Purdon's (1936) Pa. Stats.

> "All banks, banking institutions, and trust companies, selected as aforesaid, shall, upon the receipt of notice of such selection as depositories of State moneys, furnish a bond to secure payment of deposits and interest to the Commonwealth of Pennsylvania, with a proper warrant of attorney to confess judgment in favor of the Commonwealth, secured by a surety company or individual sureties, to be approved by the Revenue Commissioners and Banking Commissioner, or a majority of them, in double the amount of the deposit to be made, and, if corporate bonds are given, no one company shall be approved in an aggregate amount in excess of five times its capital, surplus and reserve. (1906, Feb. 17, P. L. 45, Sec. 5.)"

(a) It is settled doctrine that public funds deposited in a bank contrary to the requirements of statutes regulating such deposits, constitute illegal deposits. See: *Fiman* v. *State of So. Dak.* (C. C. A. 8th, 1928) 29 F. (2d) 776, 778, *cert.* denied 279 U. S. 841; *U. S. N. B. of Centralia* v. *City of Centralia,* (C. C. A. 9th, 1917) 240 Fed. 93, 95; *cert.* denied 243 U. S. 656; *Merchants National Bank* v. *School District,* (C. C. A. 9th, 1899) 94 Fed. 705, 706; *Board of Commissioners* v. *Strawn,* (C. C. A. 6th, 1907) 157 Fed. 49, 50; *Montgomery* v. *Ward*--(Ala., 1933) 151 So. 583, 585; *Poweshiek County* v. *Merchants Nat. Bk.,* (Iowa, 1928) 220 N. W. 63, 66.

(b) A claimant seeking subrogation must act fairly and equitably and be free from fault in the transaction in connection with which he claims subrogation. He will not be entitled to subrogation where he derives his claim through or from a wrongdoer.

To the foregoing effect see: *Galliland* v. *Williams,* 181 Ala. 173, 61 So. 291, 293; *Boyer* v. *Bolender,* 129 Pa. 324, 18 Atl. 127, 128; *Bates* v. *Swiger,* 40 W. Va. 420, 21 S. E. 874, 878; *Montgomery* v. *Ward, supra; Eshleman* v. *Bolenius,* 144 Pa. 269, 22 Atl. 758, 759; *Troyer* v. *Bank of Dequeen,* (Ark. 1926) 281 S. W. 14, 16; *German Savings and Loan Society* v. *Tull,* (C. C. A., 9th, 1905) 136 Fed. 1, 6.

Also see "Additional Cases", App. p. 31.

As above indicated, *supra,* p. 10, the deposit balance to the credit of the Commonwealth at the time of suspension and closing of the bank, and for which claim was allowed to the Commonwealth by the receiver in the sum of $135,000 represented moneys illegally deposited by the State Treasurer to the extent of $72,500, said sum constituting the excess over the permitted one-half of the depository bond. Had the deposits been restricted to the permitted amount of $62,500, as enjoined by State statute, the assets of the receivership would not have been required to respond for said excess of $72,500. While it is by no means suggested that petitioner participated in, or in any way was causally

responsible for, the making of said illegal deposits, nevertheless, the claim of the petitioner to subrogation in the base amount of $135,000, is necessarily derived from, and is a result of, the making of said illegal deposits by the State treasurer, in that the proof of claim in that amount allowed by the receiver to the Commonwealth embraces said sum of $72,500.

Consequently, in the light of the doctrines established by the hereinabove cited cases, (*supra*, p. 12) it would seem clear that it would be inequitable and in contravention of the vested rights of the general depositors and creditors of the receivership bank, to allow petitioner the right of subrogation for any sum in excess of the sum of $62,500, representing the maximum amount permitted to be deposited, and constituting the maximum face amount for which a claim should be allowed.

(c) Subrogation should not be allowed where the claim sought to be charged and enforced against innocent third parties—resulted from, or was caused by, the negligence of the claimant.

To the foregoing effect see: *Ft. Dodge Building & Loan Association* v. *Scott*, (Iowa, 1892) 53 N. W. 283, 284; *Coonrod* v. *Kelly*, (C. C. A. 3rd 1902) 119 Fed. 841, 848; *Porter* v. *Ourada*, (Nebr. 1897) 71 N. W. 52, 53; 60 C. J., par. 21, pp. 708-709.

It would seem clear that petitioner, as surety upon the depository bond, was chargeable with notice as to the requirements of the State depository statutes including the definite restriction upon the amount which could lawfully be deposited. Petitioner was chargeable with notice that recovery could not be had, through subrogation, as to amounts illegally deposited in excess of the permitted maximum under the bond, and it would therefore seem necessarily to follow that petitioner was guilty of negligence in not supervising the deposit account to the extent of being kept constantly informed as to the balance thereof, and that said balance was within the allowed maximum.

There can be no doubt that the books of the bank reflecting the deposit entries were at all times open to appropriate inquiry on the part of petitioner as to the condition and status of the deposit so far as amount was concerned.

Assuming and conceding that petitioner, as surety, was an innocent party in the transaction, it is obvious that the depositors and other creditors of the bank were likewise innocent parties, and had no connection whatsoever with the transaction in question. The equities, therefore, would clearly seem to be with the depositors and other creditors under the recognized maxim that where loss is sustained, affecting two innocent parties, the one whose negligence or other wrongful act made the loss possible should suffer the loss. See: page 848 of *Coonrod* v. *Kelly, supra;* and 60 C. J., p. 707.

(2) In balancing the equities, the general depositors and creditors of the receivership bank are entitled to have the benefits of the surety bond, rather than to have it weighed in the balance against them. The district court, (R. 16-17) and also petitioner, in adopting (page 15 of his petition for writ of ceriorari) the position and reasoning of the district court—to the effect that the general depositors and creditors of the bank would be receiving a "windfall" by reason of "purely fortuitous" (R. 17) circumstances, in consequence of the execution of the surety bond—were clearly in error, both in reasoning, and in the assumptions of fact, upon which reliance was made.

The district court, in stating the problem involved, and in the course of indicating the basis of its decision against the respondents, stated, in the opinion:

> "The creditor, having been paid, and so eliminated as a factor in the problem, it remains to balance the surety's rights and the interests of the general creditors. It is not easy to arrive at any solution which is entirely satisfactory and leaves one free from doubt as to the justice of the result. On the one hand, if the surety be allowed dividends on the full amount of

the creditor's claim, they will be based upon an amount in excess of what he has expended, whereas the general creditors will be sharing only on the basis of their actual advancements. If, on the other hand, the surety is limited to the amount which he has actually paid as the basis of his claim, *then the general creditors get a windfall, for no other reason than that one of them has bought and paid for additional protection which none of the others chose to take*—for, of course, if there had been no suretyship, the creditor would be proving and receiving dividends on the full amount of his claim.

"On the whole, it seems to me that, if the real objective of the doctrine of subrogation be kept in mind, we come closer to distributing the loss fairly and avoiding unjust enrichment of any interest by allowing the surety to claim on the basis of the full amount of the creditor's claim. By so doing it may be possible to reimburse him fully, and still do entire justice to the general creditors—*for it can hardly be called unjust or unfair to leave them exactly where they would have been had there been no suretyship, with their rights neither impaired nor enlarged by an arrangement with which they had nothing to do and which was purely fortuitous so far as they are concerned.*" (Italics inserted)

As pointed out in the supplementary statement of facts herein (*supra*, p. 2) the district court erroneously assumed that the surety bond had been "bought and paid for" by the Commonwealth of Pennsylvania, the statement of the court in that connection being (as set forth in the foregoing quotation) that

"the general creditors get a windfall, for no other reason than that one of them has bought and paid for additional protection which none of the others chose to take—for, of course, if there had been no suretyship, the creditor would be proving and receiving dividends on the full amount of his claim." (R. 16)

The fact is, however, as pointed out in the supplementary statement of facts herein (*supra* p. 2) the surety bond was "bought and paid for", *not* by the Commonwealth of

Pennsylvania, *but by the bank, in 1928*, and the bank paid the annual premiums upon said bond to petitioner, for a period of approximately five years prior to the appointment of the conservator for the bank in March of 1933. (See letter of October 10, 1941, appendix hereof p. 28).

Still laboring under this mistake of fact, and placing substantial reliance upon the fact thus erroneously assumed, the trial court reasoned and concluded:

> "for it can hardly be called unjust or unfair to leave them exactly where they would have been had there been no suretyship, with their rights neither impaired nor enlarged by an arrangement with which they had nothing to do and which was purely fortuitous so far as they are concerned."

The reasoning thus indulged, and the conclusion thus reached, appears substantially inequitable to the general depositors and creditors of the bank. The surety bond was procured and paid for by the bank with the presumed intent and expectancy that it would become operative in performance and payment of the penalty therein provided, only in the event of insolvency of the bank. There being no question as to the fact that the bank would be obligated to repay the deposits thereunder to the commonwealth from time to time, as demanded, there could be no other reason and no other occasion or contingency, upon which payment of the penalty under the bond would be required.

The surety bond must be considered, and relied upon, as an asset of the bank in receivership. As stated by this court in *United States Fidelity Company* v. *Wooldridge*, (1925) 268 U. S. 234, 238, in considering a fidelity bond relied upon and collected by the receiver of a national bank:

> "the right of the Railway Company was simply that of a depositor, a right to share with other unsecured creditors in the assets of the Bank, of which the bond now in suit was a part."

The surety bond involved in the instant case was for the benefit of, not only the Commonwealth of Pennsylvania as a public depositor, but it was also, indirectly, for the benefit of the general depositors and creditors of the receivership bank, in that the amount of the penalty required to be paid by the surety under the bond to the commonwealth enabled and permitted the other assets of the bank on hand at the time of suspension and closing,—and constituting a trust *res*,—to be applied toward the payment of the general depositors and creditors.

It thus follows, in consequence, that the general depositors and creditors are entitled to retain the full benefit of the assets constituting this trust *res*. *It further follows that the general creditors and depositors are not thereby fortuitously obtaining a "windfall", and that they are only realizing upon a potential asset bought and paid for by the bank prior to suspension and for the presumed purpose of meeting exactly the contingency, to wit, receivership, which did occur.*

If petitioner should be allowed, either by way of subrogation or of implied indemnity,—to participate by way of dividends upon the basis of a claim of $135,000, instead of upon a claim measured by the amount expended under the penalty of the bond, ($68,588.56) the petitioner would thereby substantially cut into the assets constituting the trust *res* retained for the benefit of the general depositors and creditors,—entirely contrary to, and beyond the measure permitted by, the surety bond. As well stated by the court below in its opinion,

> "*The risk that the debtor bank might become insolvent was the very thing which the surety company insured against and presumably was paid for so doing. That was the same risk which was taken by the unsecured depositors in the bank who, along with the surety, now seek an apportioned share of the bank's assets.* There is only so much money to go around; the more one gets the less someone else will receive. The surety and the depositors shared the same risk. It seems fair

> that they should share, in partial compensation for their loss, on the same basis. The basis on which the depositors share is the proportion of their actual loss, the amount of their deposits. The surety's actual loss is the same that it paid out, which was $68,588.56. This, we think, is the basis on which it is entitled to claim." (Italics inserted) (R. 30)

The State statutes under which the deposits in the instant case were made, and in pursuance of which the bond was given, will be found in the appendix hereof at p. 29.

It will be noted from the foregoing quotation from the opinion of the court below, that the court considered that the relation between the Commonwealth and the surety was in the nature of that of insured and insurer. The same conclusion has been reached by the Pennsylvania courts. In *Commonwealth* v. *U. S. F. & G. Co.*, (Pa. 1934) 170 Atl. 686, 688, the court said:

> "* * * Read in the light of the statutory regulation and of the object to be attained, the words used were obviously intended to insure payment, and, therefore, solvency of the bank —or, in other words, that the bank would always be in condition to pay. Though termed 'surety', defendant is an insurer. South Phila. State Bank v. National Surety Co., 288 Pa. 300, 305, 135 A. 748, and cases cited; also see the General Insurance Act of 1921 (P. L. 682, secs. 661 to 665 [40 PS secs. 832-836]). The purpose was to provide insurance of state deposits. * * * Liability was not intended to depend on the commonwealth's right to sue the bank; it was intended, inter alia, to cover a receivership. South Phila. State Bank's Insolvency, 295 Pa. 433, 145 A. 520, 83 A. L. R. 1123; National Surety Co. v. Franklin Trust Company (Pa. Sup.) 170 A. 683. Any other construction would attribute to the parties an intention to express their agreement in words that would satisfy the statute, when, in fact, they intended to disregard it, an interpretation that cannot be tolerated. * * *"

In *Young* v. *American Bonding Co.* (1910) 228 Pa. 373, 77 Atl. 623, 625, the court said:

"* * * In all essential particulars the appellee here is an insurance company, and its obligation in this particular instance was that of an insurer. It was paid for its undertaking; the amount of its compensation being based on the calculation of risk assumed. * * *"

In the case of *In Re South Philadelphia State Bank's Insolvency*, (1929), 295 Pa. 433, 145 Atl. 520, the court was considering the respective equities of a surety claiming subrogation under a depository bond, and the general depositors and creditors of the bank. The particular point with which the court was concerned in its discussion hereinafter next quoted, was the right of the surety to be subrogated to the preferred status of the Commonwealth growing out of its sovereign priority rights; and the conclusion was there reached that such priority rights intended for the benefit and protection of the sovereign, should not, in equity and good conscience, be exercised by the surety, by subrogation, to the prejudice and detriment of the general depositors and creditors of the receivership bank. The court said (p. 521):

"Though the state of Pennsylvania has a sovereign right of priority over all other creditors, it by no means follows that, on the facts in this case, such right would pass to one in the position of appellant. It must be remembered that appellant, a surety obtained and paid by the insolvent bank, not by the commonwealth, claims the right to enjoy the sovereign privileges of the latter, and this under the equitable doctrine of subrogation; the right claimed is to a preference over all other depositors of the bank. Since the right of priority of the sovereign state exists *pro bono populo*, it follows that, where a situation arises in which the state, having been paid in full, is not immediately concerned, and where the transfer of its right of priority would result in prejudice to one class of its citizens for the benefit of another, it cannot be held that the good of all the people would thus be served. It may well be assumed that the ordinary depositor in a bank which enjoys state deposits, knowing that, in event of the insolvency of the institution, the state has the right to

priority of payment, would likewise know that the laws of Pennsylvania require all state deposits to be secured by bonds with ample security thereon. Furthermore, since the doctrine of subrogation is an equitable one, the ordinary depositor might properly believe that, in event of the insolvency of their depository, if no necessity existed for the state to protect itself by exercising its sovereign right to priority of payment, that right would not be used to his prejudice, and, on such basis, he would make, or continue, his deposits; therefore the doctrine in question should not be allowed to operate in a manner to produce prejudicial results to such depositors.

• • •

"We conclude that appellant surety company has the equitable right to stand in the shoes of the commonwealth as a depositor, but not to enjoy its right of priority over other depositors. When the bank failed, the commonwealth had all the rights of an ordinary depositor; those rights passed by subrogation to appellant. The commonwealth had also the sovereign's right to priority of payment over other depositors, but, owing to the peculiar nature of that right, it would not pass by subrogation to appellant."

By way of analagous application to the instant case, of the discussion contained in the foregoing quotation, it may be observed:

(a) That although the surety company was there allowed subrogation to the rights of the Commonwealth as a depositor, such allowance was based upon the fact that the surety had paid the full amount of the deposit of the Commonwealth in the receivership bank.

(b) Adopting, (but not quoting) and paraphrasing to the extent considered appropriate, portions of the language contained in the foregoing quotation, it seems fair to state, by analogous application that:

It may well be assumed that the ordinary depositors in a national bank in Pennsylvania which enjoys State deposits, knowing that, in the event of the insolvency of the bank, the State would enjoy, in effect, a pre-

> ferred status in view of the fact that the laws of Pennsylvania require all State deposits to be secured by bonds with ample security thereon, and further, since the doctrine of subrogation is an equitable one, the ordinary depositors might properly believe that in event of insolvency of their bank, the State would be paid by the surety under the penalty of its bond (*and that such bond would be in double the amount of the State's deposit, as required by law*) and that through application of the doctrines of subrogation, the surety might acquire such rights, remedies or securities as the State possessed for the protection and enforcement of its depository rights, and that under such circumstances the depositors could safely continue their deposits in the bank, and that, in view of such circumstances, and upon the assumption that all requirements of the State depository law had been made, *the ordinary depositors could well assume further that such rights of subrogation as the surety might acquire through payment of the deposit of the State, would not be used to their prejudice nor to detract from nor diminish the vested rights which they had in the assets possessed by the bank at the time of its failure and suspension, constituting a trust res required by law to be administered for the benefit of the depositors and creditors of the bank.*

It is only fair, of course, that the fact that petitioner is a corporate surety should not be used as a basis of undue discrimination, nor to deprive it of any rights to which it is lawfully entitled, whether by way of subrogation or otherwise. However, it is proper, in weighing the equities, to have in mind the situation indicated by the Pennsylvania Supreme Court in *Young* v. *American Bonding Company*, (1910) 228 Pa. 373, 77 Atl. 623, 626, wherein the court said:

> "• • • The trend of all our modern decisions, federal and state, is to distinguish between individual and corporate suretyship where the latter is an undertaking for money consideration by a company chartered for the conduct of such business. In the one case the rule of *strictissimi juris* prevails, as it always has. With respect to the other, because it is essentially an insur-

> ance against risk, underwritten for a money consideration by a corporation adopting such business for its own profit, the courts generally hold that such a company can be relieved from its obligation for suretyship only where a departure from the contract is shown to be a material variance. * * *"

The above extract was quoted with approval in *Sokoloff* v. *Fidelity and Casualty Co.*, (1927) 288 Pa. 211, 135 Atl. 746; *In re Harr*, (Pa. S. Ct., 1935) 179 Atl. 725; and *Penn R. Co.* v. *Fidelity & Deposit Co.*, (C. C. A. 3d, 1936) 81 F. (2d) 526, 528. See also footnote 4, (R. 30) of the opinion of court below (116 F. (2d) 77), citing 12 A. L. R. 382 and 94 A. L. R. 876.

C.

THE CASE OF MERRILL v. NATIONAL BANK OF JACKSONVILLE, (1899) 173 U. S. 131, RELIED UPON BY PETITIONER, DOES NOT SUPPORT ITS POSITION, BUT, TO THE EXTENT APPLICABLE TO THE INSTANT CASE, SUPPORTS THE POSITION OF RESPONDENT.

Petitioner relies also upon *Merrill* v. *National Bank of Jacksonville, supra,* to support its position. Analysis of the case would seem to indicate that it does not support petitioner's contentions, but that, to the extent that the *Merrill* case is applicable, it supports the contentions of respondent.

(1) Analysis of the Merrill case:

The First National Bank of Palatka, Florida, was in receivership. The National Bank of Jacksonville, Florida, held a claim against the First National Bank, for approximately $10,000.00, secured by certain collateral, and sought to prove its claim against the First National Bank in the face amount of approximately $10,000.00 (the amount of the indebtedness at the time of suspension of the First National Bank) and to retain said collateral for future liquidation and application, as permitted by law. The National Bank

of Jacksonville contended that it was entitled to receive dividends from time to time upon said face amount of said claim without surrendering to the receiver said collateral. The receiver, by direction of the Comptroller of the Currency, refused to allow the claim, for dividend purposes, in the face amount of approximately $10,000, and insisted (p. 132) that said creditor must, first "exhaust the collaterals given to secure the certificate of deposit, and then * * * prove for the balance due, after applying the proceeds of the collaterals in part payment". The issue thus raised, was, in due course, presented to this Court for determination, on appeal. This Court held:

(a) The assets of the insolvent bank constituted a trust *res* for the benefit of all of its creditors, and a creditor, upon proof of claim, acquired a vested interest in the trust *res.* (pp. 136, 138).

(b) "The distribution is to be 'ratable' on t[illegible]ms as proved or adjudicated, that is, on on[illegible]e of proportion applicable to all alike. In or[illegible] to be 'ratable' the claims must manifestly be estimated as of the same point of time, and that date has been adjudged to be the date of the declaration of insolvency. *White* v. *Knox*, 111 U. S. 784." (p. 143.)

(c) In quoting from *White* v. *Knox*, 111 U. S. 784, this Court said, in the *Merrill* case, (at p. 144 thereof):

"Mr. Chief Justice Waite, speaking for the court, said: 'Dividends are to be paid to all creditors, ratably, that is to say, proportionally. To be proportionate they must be made by some uniform rule. They are to be paid on all claims against the bank previously proved and adjudicated. All creditors are to be treated alike. The claim against the bank, therefore, must necessarily be made the basis of the apportionment * * * The business of the bank must stop when insolvency is declared. Rev. Stat. sec. 5228. No new debt can be made after that. The only claims the Comptroller can recognize in the settlement of the affairs of the bank are those which are shown by proof satisfactory to him or by the adjudication of a competent court to have had their origin in something done before the insolvency. It is

clearly his duty, therefore, in paying dividends, to take the value of the claim at that time as the basis of distribution'." (p. 144)

"In short, the secured creditor is not to be cut off from his right in the common fund because he has taken security which his co-creditors have not. Of course, he cannot go beyond payment, and surplus assets or so much of his dividends as are unnecessary to pay him must be applied to the benefit of the other creditors. And while the unsecured creditors are entitled to be substituted as far as possible to the rights of secured creditors, the latter are entitled to retain their securities until the indebtedness due them is extinguished." (p. 141)

• • •

"Our conclusion is that the claims of creditors are to be determined as of the date of the declaration of insolvency, irrespective of the question whether particular creditors have security or not. When secured creditors have received payment in full, their right to dividends, and their right to retain their securities cease, but collections therefrom are not otherwise material. Insolvency gives unsecured creditors no greater rights than they had before, though through redemption or subrogation or the realization of a surplus they may be benefited." (p. 147)

(2) Comments and observations concerning the Merrill case in so far as it may apply to, or may be distinguished from, the instant case:

(a) As indicated by the court below (R. 28), the Merrill case "did not concern a surety and, therefore, is not directly in point here." The instant case concerns "the rights of a surety who has paid a part of a claim against a national bank which is in liquidation", and the extent to which the surety may be entitled to subrogation, if at all, by reason of having paid a portion of the claim of the creditor protected by the bond. Such questions were not involved in the Merrill case.

(b) In the Merrill case the secured creditor's claim against the bank was measured by the amount of its de-

posit balance as of the date of suspension of the bank. As previously indicated herein (*supra*, p. 6), the claim of the petitioner, as surety, should be measured by its claim against the bank as represented by the amount paid by petitioner to the creditor to the extent required under the bond. The bank does not owe petitioner the amount it originally owed the secured creditor ($135,000); it owes the petitioner only the amount lawfully expended under the requirements of the bond.

(c) In the Merrill case the court held, in effect, that when dividends paid by the receiver, plus proceeds of liquidation of collateral, equalled the amount of the creditor's claim, said claim would be discharged. The result under such circumstances would be that the remaining assets of the receivership would be retained for distribution to the general depositors and creditors.

In the instant case no unliquidated collateral remained in the hands of the Commonwealth, and consequently, there was no basis of subrogation in that respect.

So far as subrogation to rights and remedies are concerned, the situation is obviously different from what it would have been if the secured creditor had held, as collateral, a note or other obligation owing to the bank by a third party, in which event it may be assumed, for discussion, that petitioner would have succeeded, by subrogation, to the rights and remedy of the Commonwealth, as a creditor, to pursue the collateral claim against the third party for the purpose of applying it upon the bank's indebtedness to the Commonwealth. However, in the instant case, the claim of the Commonwealth was against the bank, and the claim of petitioner is against the bank. Therefore, it would appear, in substance, that there is no *res* or *corpus*, either by way of collateral or remedy to which petitioner can be subrogated. Further, if full weight be given to the established principle in the Merrill case that the claim of the secured creditor is extinguished when fully paid by dividends and realization upon collateral, it would seem to

follow that there remained no claim, on the part of the Commonwealth, to which petitioner could be subrogated.

(d) The formal assignment executed by the Commonwealth to petitioner would appear to have no bearing upon the issues here involved. Obviously, under equitable doctrines, substance rather than form must be considered, and petitioner cannot, through the form of an assignment, enhance or increase his claim against the insolvent bank to the detriment and prejudice of the general depositors and creditors. See: *Withers* v. *D'Auria Bank & Trust Co.* (1937), 122 N. J. Eq. 503, 195 Atl. 298; *Meyers* v. *Bank of America Nat. Trust & Savings Ass'n., et al.* (1938), 77 Pac. (2d) 1084, 1086.

As stated by the court below:

> "As a possible makeweight it can be added that the surety in this case took an assignment from the creditor, after the surety had paid the sum due the creditor. This makeweight, however, has no added force since, at the time of the assignment, the claim had been discharged. We do not think that the assignment added anything to the rights which the surety already had. See Louisville Trust Co. v. Royal Indemnity Co., 230 Ky. 482, 20 S. W. (2d) 71 (1929)." (R. 29)

Our examination of the authorities indicates that the issues involved in the instant case have not heretofore been passed upon by this court. Counsel for petitioner appear to have reached the same conclusion. However the decision of the court below is in accord with decisions in the closely analogous cases of: *Maryland Casualty Company* v. *Cox*, (C. C. A. 6, 1939) 104 F. (2d) 354; *U. S. F. & G. Co.* v. *Hood*, (1934) 206 N. C. 639, 175 S. E. 135; *Ward* v. *First Nat. Bank of Caruthersville*, (C. C. A. 8, 1935) 76 F. (2d) 256; *In re Kent Refining Co.*, (W. D. Mich., 1937) 20 F. Supp. 661.

Additional comments on cases cited by Petitioner will be found in Appendix at p. 35.

V.

CONCLUSION.

The judgment of the court below should be affirmed.

Respectfully submitted,

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(Counsel for Comptroller of the Currency),
Attorney for Respondents.

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LEE ROY STOVER,
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VI.

APPENDIX.

Law Offices of

JOSEPH A. SLATTERY

123 South Broad Street

Philadelphia

October 10, 1941.

George P. Barse, Esq., General Counsel,
Office of Comptroller of the Currency,
Room 309, Treasury Building,
Washington, D. C.

Dear Sir:

You have asked us to clarify the record in the matter of American Surety Company of New York v. Bethlehem National Bank et al., now pending in the Supreme Court of the United States, on the point whether the petitioner surety company was a paid surety. Confirming our conversation on the telephone today, we are writing to advise that petitioner in this case was a paid surety. The respondent Bank paid to it an annual bond premium to maintain in effect the bond of December 10, 1928, and the bond was in effect and the Commonwealth's deposit was secured thereby at the time of the appointment of the conservator on March 15, 1933, as averred in Paragraph 6 of the complaint (R. 3).

It is agreed between us that the foregoing facts may be submitted to the Supreme Court of the United States for its consideration to the same extent and effect as if included in the formal transcript of record, and that our agreement in this regard may be evidenced by the insertion of a copy of this letter as an appendix of Respondents' brief which you are about to file.

Yours very truly,
(Signed) RUTLEDGE SLATTERY.

RS/hs

Excerpt from Section 1102 of Act No. 274, approved June 7, A. D. 1923, known as the Administrative Code, as amended by Act No. 164, approved April 13, A. D. 1927.

Section 1102. Board of Finance and Revenue. * * * the Board of Finance and Revenue shall have the power and its duty shall be:

(c) To select and designate as depositories for the State moneys, banks, banking institutions or trust companies, which are subject to national or State supervision and each of which

1. Has made written application to the State Treasurer for a deposit of State moneys designating the amount of deposit solicited and accompanying its application by a written statement showing the amount of its capital actually paid in, the amount of its surplus, the number of its stockholders, and whether its stock is well distributed or largely held by a few individuals, and the length of time that said institution has been engaged in business under its charter. Each such statement shall be verified by the oath or affirmation of the president, cashier or trust officer as the case may be, and the State Treasurer shall present the same to the Board for its consideration within thirty days after the receipt thereof, provided, that where the selection of any bank, banking institution or trust company as a depository of State moneys has been made by the former Revenue Commissioners and the Banking Commissioner, or a majority of them as heretofore provided by law such selection and the deposit made in accordance therewith in such bank, banking institution or trust company shall in no way be affected by the failure of such bank, banking institution or trust company to have made application in the manner herein provided but it shall be the duty of the depository so selected to furnish on request the information aforesaid verified in the manner stated.

2. Shall upon the receipt of notice of its selection as a depository of State moneys furnish a bond to secure payment of deposits and interest to the Commonwealth of Pennsylvania with a proper warrant of attorney to confess judgment in favor of the Commonwealth secured by a surety company or individual sureties to be approved by the board in the amount of the deposit to be made. If a corporate bond be given no one surety company shall be approved in an aggregate amount in excess of five times its capital, sur-

plus and reserve. Provided, that in lieu of the surety bonds of surety companies or of individuals as aforesaid the deposit of State moneys may be secured by the deposit with the State Treasurer, of United States, municipal or county bonds to be approved by the board in an amount measured by their actual market value equal to the amount of deposit so secured and twenty per centum in addition thereto. Said bonds shall be accompanied by proper assignment or Power of Attorney to transfer the same and said trust deposit of securities shall be maintained on request at the amount aforesaid in case of any depreciation in the value thereof.

3. Agree to pay interest upon all State deposits at the rate of not less than two per centum per annum upon active deposits and not less than three per centum per annum upon non-active deposits, and that all collections shall be made for the Commonwealth without cost or compensation.

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(f) To see that no bank, banking institution or trust company shall receive a deposit of State moneys in excess of twenty-five per centum of its paid-in capital and surplus, or have at any one time an aggregate of deposits in excess of five hundred thousand dollars. This section shall not apply to institutions to be designated by the board as active depositories of State funds subject to daily check by the State Treasurer, but at no time shall the combined deposits in the active depositories exceed the total sum of ten million dollars.

ADDITIONAL CASES ON SUBROGATION.

Old National Bank v. *Swearing*, 72 S. W. (2d) 545, 548 & 549; 167 Tenn. 529

FACTS: Life tenant under will borrowed money to pay taxes and improve property. Gave bank a note secured by mortgage. It was claimed that life tenant did not have the power under the will to mortgage property and bank contended that if the mortgage was not valid they should be subrogated to the claims of the lienors whose demands were discharged.

HELD: As to the lien for repairs, there was no subrogation as said lien had expired prior to the payment by the bank.

As to the lien for taxes, the bank could not be subrogated as search of title would have disclosed that in a prior proceeding it was determined that the life tenant did not have the power to incumber property, so the bank was guilty of such culpable negligence as to preclude any favor at the hands of the Court of Equity.

Morrah v. *First National Bank*, 65 S. W. (2d) 830, 831 (1932)

QUESTION: Right of bank to become subrogated to first mortgage lien which was discharged and paid by bank upon faith of release of note secured by second mortgage holder who, in fact, had sold note prior to release.

Second mortgage holder attempted to have said mortgage declared a first and prior lien.

HELD: Bank not guilty of culpable negligence, but if so would not have been entitled to subrogation which was granted in this case. Also, no showing that the right of the second mortgage holder was prejudiced and thus subrogation was not denied.

Wallace v. *Benner*, (1931) 156 S. E. 795, 799

"The exceptions to the general rule to the doctrine of subrogation: (1) The relief is not granted to a volunteer; (2) nor where the party claiming relief is guilty of culpable negligence; (3) nor where to grant relief will operate to the prejudice of the junior lienholder."

However, the facts in this case did not come in any of the above exceptions, and the subrogation was granted.

Huey v. *Brand*, (1936) 92 S. W. (2d) 505, 507

FACTS: The tax collector illegally deposited funds in the bank and the president of the bank and another executed a surety bond. Upon failure of the bank, Huey paid the state and was allowed a general claim against the bank.

The present action is for the purpose of establishing a preferred claim on the theory that Huey was entitled to the right of subrogation to the preferential right of the sovereignty, which was denied.

"The rule of preferential right of sovereignty to be paid ahead of its citizens comes from monarchial Europe. It is held to be transferred therefrom into the law of democratic America by the legislative adoption of the English common law. It was a prerogative that belonged to ancient kings, before justice for the common man was born. If it may be justified as a cold legal formula, now a part of American jurisprudence, we doubt that either its origin, or the result of its application to the average bank failure, is such as to produce enthusiasm or profound respect in the modern judicial mind of this country. This much is said to show that courts should recognize its binding force in any form only in a clear case. Concerning it the Supreme Court of Pennsylvania has held: 'The proper rule is that the state's right to a preference over other creditors, being a sovereign right enjoyed for the benefit of all the people, cannot be transferred to individuals except by express legislative sanction.' In re South

Philadelphia State Bank's Insolvency, 295 Pa. 433, 145 A. 520, 83 A. L. R. 1123, at page 1125. However, we need not announce such as the Texas rule Upon equitable principles more hoary with age than Anglo Saxon jurisprudence, Huey is not entitled to the right of subrogation, conceding the preferential right of sovereignty, and that same may be transferred to an individual. We quote some of these:

'Subrogation does not owe its origin to statute or custom, nor is it a doctrine of the common law. It originated in equity and is a creature of equity, a doctrine of equity jurisprudence which was adopted by equity from the Roman or the civil law. * * *

'Subrogation is founded upon principles of justice and equity and rests upon the principle that substantial justice should be attained regardless of form. Its basis is the doing of complete, essential and perfect justice between all the parties without regard to form. * * *

'It will not be enforced unless there is some equitable doctrine upon which it can be predicated, and only when the applicant therefor has an equity to invoke and his cause is just and its enforcement is consonant with right and justice, and then only in a clear case. It will not be allowed where it would be contrary to public policy, or where it would accomplish by indirection that which a statute forbids to be done by direction. * * *

'Nor can the doctrine be extended so as to authorize the application of the principle for the relief and benefit of a party who voluntarily surrenders a right or suffers an injury, the consequence of his own willful neglect or wrong, or who has connived at and assisted in the wrong, for one seeking subrogation must come into court with clean hands. * * *

'The person seeking subrogation must act fairly and equitably and be free from fault. It will not be allowed where he has intermeddled with the rights of others, or is guilty of fraud or culpable negligence, or where he would derive an advantage from, or establish his claim through, his own negligence, or, in any way, would thereby reap advantage from his own wrongdoing. * * *

'Subrogation will be granted only where an equitable result will be reached. It will not be allowed when to do so would be inequitable or where it would accomplish injustice.' 60 C. J. pp. 696, 697, 698, 699, 701, 702, 707, 708 and 709.

"See, also, Padgett v. Young County (Tex. Civ. App.) 204 S. W. 1046; 60 C. J. p. 729.

"In this case Huey openly flaunted the law of the state and violated his oath of office by depositing state funds illegally. A. P. Borger conspired with him in this high-handed act. Now both are before a court of equity, claiming in effect a right of preference over the individual depositors of the Borger State Bank, based upon their own wrongdoing. Who would pay Huey if his claim be allowed? Obviously the general depositors would contribute. Laborers, bended with toil, gingham-clad washer women, the aged, the infirm, even the orphan—these a part of the usual run of bank depositors are to be made to enlarge the bank account of Huey and enrich the estate of A. P. Borger. This consequence is claimed to flow directly from a violation of Huey's official duty in making an illegal deposit with Borger's bank. We confess little enthusiasm or respect for the rule which gives the state the legal right to take the assets of an insolvent bank from the above class, and none at all for the rule invoked by both Huey and Borger's estate in this case. That it would work a loss and grave injustice to the general depositors of the Borger State Bank is, to our mind, as clear as sunlight. Such a contention was rejected by the Pennsylvania Supreme Court upon the same reasoning we use here. In re South Philadelphia State Bank's Insolvency, 295 Pa. 433, 145 A. 520, 83 A. L. R. 1123.

"The judgment of the trial court allowing the Huey claim as a preference is hereby reversed and rendered in favor of the Banking Commissioner."

ADDITIONAL COMMENTS ON CASES CITED BY PETITIONER.

Fouts v. *Maryland Casualty Co.* (C. C. A. 4th, 1939) 30 F. (2d) 357.

The opinion discloses at pg. 359 that the surety company was asking for the allowance of an indemnity claim and payment of bank dividends thereon before the State Treasurer had received all the dividends due on the state's claim, the court stating:

> "It is shown by the record that Mr. Lacy has not yet received all his dividends, in fact there is a considerable sum in the receiver's hands to be distributed, yet the court permits the proving and filing of the casualty company's claim for a certain fixed amount necessarily greater than the company's final loss."

The above statement indicates that expressions in the last paragraph of the opinion of the court with respect to the surety's right of subrogation cannot be determinative of the question involved in the instant case and must be considered as dicta.

American Surety Co. v. *De Carle,* (C. C. A. 9th, 1928) 25 F. (2d) 18.

In this case the full amount of the depository bond was paid by the surety and left unpaid a substantial amount of the County Treasurer's deposit in the bank. However, the surety, basing its claim against the receiver on its indemnity agreement, sought allowance of a claim for dividend purposes before the Treasurer was paid in full. The court denied the surety's claim based on the indemnity agreement and indicated the surety's only right would be that of subrogation after the claim of the County Treasurer was satisfied. Clearly, the court's statements with respect to subrogation, though relied upon by the petitioner, were merely *dicta* in this case.

City of Oakland v. *Hartford Accident & Indemnity Co.,* (C. C. A. 6th, 1936) 81 F. (2d) 717.

The City sued the surety to enforce payment upon a depository bond covering funds deposited in a state bank by the City. Upon suspension of the bank, the City in a prior

suit in the state courts was denied a claim for dividend purposes for the full amount of the City's deposit, the state court requiring a deduction of the proceeds of pledged bonds in determining the amount of the City's claim for dividend purposes. This case in the Federal court was a suit by the City against the surety company only, to recover the deficiency after applying the proceeds of the collateral and a dividend. The court held judgment should have been rendered against the surety for the difference between its liability on the bond nd that portion of the deposit for which the City had been compensated by application of the dividend payment and the collateral proceeds. As the surety had never paid its obligation on the bond, no questions of subrogation were before the court for consideration. As to that portion of the court's opinion holding the City was entitled to receive a dividend upon the full amount of the claim without deducting the value of the collateral, it will be noted that this point was *res adjudicata*, in view of the previous decision by the state court to the contrary.

In re Thompson (W. D. Pa. 1924), 300 Fed. 215.

A brief statement of the facts in the above entitled case will show that the holding of the court is not applicable to the facts of the instant case. In that case the holder of fifteen promissory notes compelled an indorser to pay the entire indebtedness. The indorser then assigned his claim for value to the Federal Security Company, which proved the claim against a co-indorser's bankrupt estate. Two other co-indorsers were insolvent. Held: That the Company was entitled to dividends on the entire claim as proved, for as a surety it was subrogated to the rights of the principal debtor.

It will be noted that the *entire debt* was paid by the surety; that the surety's claim was filed against a *bankrupt* estate; and there was not involved a question of the construction of the ratable distribution provisions of the National Bank Act. The case involved the rights of an individual surety, as distinguished from a corporate surety. The Pennsylvania courts in a long line of decisions have held that the rule of *strictissimi juris* in favor of an individual surety does not apply to a contract of suretyship by a corporation, underwritten for a money consideration for profit. *Young* v. *American Bonding Co.*, (1910) 228 Pa. 373, 77 Atl. 623; *Shaw* v. *New Amsterdam Cas. Co.*, (1933)

310 Pa. 213, 164 Atl. 916; *Dairymen's Co-operative Sales Co.* v. *Maryland Cas. Co.*, (1934) 11 F. Supp. 423, aff. C. C. A. 78 F. (2) 1014; *Justice* v. *Empire State Surety Co.*, (Pa. 1913) 209 Fed. 105, aff. 218 F. 802.

Lidderdale's Executors v. *Executor of Robinson*, (1827) 25 U. S. 594.

The question involved was whether a joint endorser of a bill of exchange who had paid more than his share was entitled to priority of payment under the Virginia law against the estate of a co-endorser. The Virginia act provided that protested bills of exchange had equal dignity with a judgment after the death of the drawer or endorser and the executors or administrators shall suffer judgment to pass against them for all debts due upon a protested bill of exchange before payment of other debts of inferior dignity. The court granted priority to the endorser in the amount by which his payments had exceeded his share of the debt. The case does not appear to involve a problem of subrogation of a surety to rights of a creditor in the distribution of assets of an insolvent national bank under a ratable distribution statute, as no statutory priority of payment against an insolvent national bank is possible under the decisions of this court. *Cook County National Bank* v. *U. S.*, (1882) 107 U. S. 445; *Davis* v. *Elmira Savings Bank*, (1896) 161 U. S. 275; *Old Company's Lehigh* v. *Meeker*, (1935) 294 U. S. 227; *Jennings* v. *U. S. F. & G. Co.*, (1935) 294 U. S. 216.